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General Business Conditions

THE price and wage "freeze"—if that is the correct term—of course overshadows other developments in business during January. Differences of opinion as to whether general price and wage controls were desirable or feasible, and if so as to timing and method, have been acute. The contention of Mr. Valentine, as Economic Stabilization Administrator, that the move should be deferred until his agency was better staffed cost him his job. Almost all economists would assign to price and wage ceilings a subordinate place in the anti-inflationary program, and many consider them likely to be ineffective or disruptive, or both. People with experience in the wartime Office of Price Administration have been among the most insistent in arguing that the main line of defense this time should be government economy, adequate taxation and credit restraints, without which they foresee a repetition of the frustrations and defeats of 1942 to 1946.

What has finally brought general ceilings into effect is the feeling that the inflationary forces

were steadily gaining ground, and that something direct, drastic and dramatic had to be done about it. Prices, which reached new alltime peaks before the end of 1950, have continued to rise, carrying the wholesale price index 14 per cent above the pre-Korean level. Wage increases have moved around the circle. In December the average wage in manufacturing was \$1.54 an hour, up 9 cents or 6 per cent since June, and \$64.15 a week, up \$5.30 or 9 per cent. The cost of living (consumers' price index of the Bureau of Labor Statistics) in December was 4.8 per cent above last June and doubtless has risen further since.

In choosing between spending and saving, more people obviously are leaning toward spending, for retail trade has been booming again in a fashion reminiscent of last July and August. Department store sales since Christmas have been 31 per cent above a year ago. People have larger incomes, they are uncertain how long they will be able to get all the things they want, and above all they have expected prices to keep on advancing. In the wholesale markets merchants are buying farther ahead and in greater volume, and the industries are not only scrambling for materials but spending record amounts on equipment and expansion programs.

Aims and Limitations of the Freeze

Under these circumstances the argument that fiscal and monetary moves were too slow and uncertain, and that the situation could not wait, has prevailed. The ceilings are intended to accomplish a triple purpose—to stop the price advance as effectively as possible, to diminish expectations of higher prices and the buying stimulus that goes with them, and to repress the increases in spendable incomes that derive from price and wage markups.

Now that differences of opinion have been overborne and a decision reached, all people have the obligation to join wholeheartedly in the effort to enforce the ceilings and make them

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work. The common duty in any society is to abide by the rules, and the public spirited men who have made the decision in the sincere conviction that the public interest required it are entitled to support.

When this is said, however, it must be added that the stabilization authorities themselves claim only to have chosen the lesser of two evils, and are under no illusions as to the immense difficulties of their course wholly apart from the task of enforcement. They have the wartime experience to draw on, and they know that when they establish general ceilings their troubles are not over, but on the contrary have just begun. They know that after freezing prices on one day, on the next they must start making exceptions and giving relief to allow production and trade to go forward. For general ceilings based on some arbitrary date freeze price and wage relationships that are out of balance and untenable as well as those that are balanced and workable. They freeze prices that are below replacement costs as well as those that are above. They freeze margins that are inadequate as well as those that are excessive. They freeze losses as well as profits, and wage rates which are too low or too high to distribute labor in the proportions needed as well as rates which are equitable and correct. In many of these areas the controls must allow adjustments if the economic organization is to remain in working order.

The present regulation rewards those who have raised prices most. It penalizes many who have observed the request to hold prices at December 1 levels. It freezes retail prices and wholesale prices as of the same base period, although some articles of general merchandise have sold at wholesale during the period for as much or more than at retail, due to the lag in retail markups. The December 1 "pricing standards", in fact, forbade distributors from selling on a replacement cost basis, requiring them to base prices on acquisition cost. This problem of the lag in adjustment to replacement cost exists in some degree at all levels. Unless relief is given distribution will be disrupted.

From the effective date of the regulation, prices of imported commodities will be under ceilings whether they conform to the ideas of foreign sellers or not. If inflationary trends abroad continue and foreign selling prices rise above what our buyers are allowed to pay, relief will be called for.

These are examples of the rigidities which make blanket "freezes" disruptive and which will have to be dealt with in one way or another if

production and trade is to go forward. The problems are recognized by the stabilization authorities. Their announced intention is to replace the freeze as far as possible with tailor-made dollar and cents ceilings, and regulation of markups, and they intend to carry out the task as rapidly as possible. The wartime experience, however, is not reassuring. After the General Maximum Price Regulation of April 28, 1942 was adopted, hundreds of price adjustment petitions alleging hardship descended on the OPA. But in the words of "The United States at War", a history prepared by the Bureau of the Budget in 1946:

The national office lacked facilities to assemble and analyze data relevant to these cases, and no general policies had been laid down to guide the personnel in granting adjustments. As a result the national office during the summer of 1942 found itself swamped with work which it was not equipped to handle which delayed solution of pressing administrative problems and which interrupted essential development of new price control techniques. One result was to delay for months the anticipated replacement of the general freeze with new tailor-made price regulations, e.g., dollars and cents regulations, which finally replaced GMPR for many commodities . . . The OPA field organization was even less ready to absorb the administrative load.

Similar problems of adjustment, to say nothing of enforcement, lie ahead.

Exemptions Weaken Controls

Price control problems are further complicated by the fact that under the terms of the Defense Production Act ceilings cannot be placed on agricultural products at less than (1) the current "parity" or (2) the pre-Korean price, whichever is higher. This compels the exemption from the blanket order of most farm products, the exceptions being wool, mohair, cotton, beef, lamb and pork, cottonseed, flue-cured tobacco, rice and prunes. Prices of meat animals, being above parity, could be frozen under the law but the decision is to place the ceilings on meat directly. Livestock prices therefore are indirectly frozen. But feedstuffs are free to advance, and the livestock industry thus can be "squeezed". Grains, dairy products, most types of tobacco, and fruits and vegetables are free to rise, and if they do the processed foods made from them will have to rise also.

Because of these statutory provisions and the relief that will have to be granted in other fields, the cost of living plainly can rise further. If it does the pressures for equivalent wage increases — guaranteed in many cases by the escalator clauses effective if the cost of living index rises — can be expected to push wages upward. Temporarily, wages also have been frozen, but a

solid freeze is by common consent impracticable, and adjustments will have to be made to keep production going.

The Wage Stabilization Board is drafting a statement of policy to supplant the freeze. No comment can be conclusive until the statement is issued. However, the labor unions, who are equally represented with employers and the public on the nine-man Wage Stabilization Board, have made their attitude plain. The labor members of the Board refused to sign the wage freeze order, and the United Labor Policy Committee has formally stated that wage stabilization must permit adjustment of rates to compensate for increases in the cost of living, to correct sub-standard wages and inequities, and to embody the principle that wage earners should share in the benefits of increased productivity. Hence the unions, should they have their way, would retain virtually as much latitude for demanding wage increases as in normal times. Wage increases force industrial costs and prices upward, in turn raising the farm parity, and so around the circle.

Wartime Experience

During the war the statutory prohibition against ceilings on farm products below a stated level—originally 110 per cent of parity—was a thorn in the side of the price and wage stabilization measures. Between the establishment of GMPR April 28, 1942 and the following September, food prices exempt from the order rose $3\frac{1}{2}$ per cent per month and all food costs $1\frac{1}{4}$ per cent per month. A new stabilization act was passed October 2, 1942 reducing the permissible ceiling levels from 110 per cent to 100 per cent of parity or to the highest price between January 1 and September 15, 1942, whichever was higher. This brought more commodities under ceil- but did not stop the rise; food prices by the following April were up another 13 per cent. Attempts to enforce price rollbacks and use subsidies failed for one reason or another. In the end it was not price ceilings, but rationing, which flattened out the rise. During all this period, and later, pressure for wage increases was unceasing, and only by a narrow margin was a complete breakdown of the wage stabilization program averted.

The wartime history need be pursued no further. The conditions of the time, including the black markets, the disruption of distribution, the displacement of familiar products and lines by new "upgraded" products at higher prices, and the disorder and waste, are within memory.

In the end the price rise was not avoided, but deferred to the 1946-48 period.

In summary, there are two types of limitations on the efficacy of ceilings. One is that the economy does not function well when prices and wages are not free to change, for they are the guides which normally direct enterprise, govern the distribution of resources, balance supply and demand, permit the clearing of the markets, and thus keep the producing and distributing organization in working order. The second limitation is in the statutory exemption of commodities with a major influence upon the cost of living; and probably also in loopholes in the wage stabilization program.

What the Freeze May Gain

By reason of these two limitations, the first inherent in the nature of economic relationships and the second chiefly political, few can expect price and wage controls to have more than partial success, or to be tolerable for more than a limited, although uncertain, time. They have two virtues. One is that they enforce restraint where restraint otherwise would be lacking. Second, by so doing they gain valuable time for a more fruitful attack on the basic causes of inflation. They help hold the line while the measures already taken to contain inflationary pressures at their source have time to exert their full effect, and pending adoption of new and stronger measures.

The need now is to use the time gained to advantage. If the evils of continuing inflation are to be escaped, the chief reliance must be on measures to increase production and saving and reduce spending. Such measures include government economy at all levels—federal, state and local—and personal restraint. They include heavier taxation to absorb the excess of income now available for spending, and to turn the money into the Treasury to pay for the defense effort. They include monetary and credit policies to repress the inflation of purchasing power through expansion of credit and of the money supply. They should also include longer hours of work.

In the end the success of price and wage control measures will depend on such basic policies. Unless total spending can be held in line with the goods available, the pressures will find their way through the loopholes of the controls.

It is also in order to ask the Congress to do what is necessary to make the controls now adopted more workable. They should not be hamstrung by prohibitions which prevent agricultural prices from being brought under ceil-

ings, and which leave the way open for the cost of living to continue to rise. This prospect is the greatest barrier to effective wage stabilization.

Magnitude of the Defense Effort

During most of the time since the Korean war began people have been uncertain as to the extent of the national effort required and what was expected of them. There has been little authentic information as to the size of projected defense spending. Probably the uncertainties were unavoidable. Nevertheless, the lack of a firm basis for calculations has left the way open for uninformed opinions, speculation, and extreme statements both public and private, with respect to the diversion of production and inflationary effects to be expected. Undoubtedly there has been "inflation by publicity", which has fostered a contagious state of alarm and scare buying.

In the federal budget for fiscal 1952 are included figures which, although of course subject to change, provide a firmer basis for measuring the national effort. According to President Truman's classification of the budget items, major defense expenditures, including total foreign aid, in the twelve months beginning next July 1 are expected to reach \$52.5 billion. A pertinent question is what share of the country's output these expenditures will require.

Production of goods and services (gross national product) in the fourth quarter of 1950 is estimated by the Council of Economic Advisers to have reached an annual rate of \$297 billion. In the annual economic review presented to the President by the Council (page 76) the statement is made that "maximum production for 1951 should bring an annual rate of output of about \$310 billion, at 1950 prices, by the end of the year". This will not be considered an unreasonable estimate, in view of the figures already reached. Certainly it can be accomplished if all people work together. If \$310 billion should be the total for fiscal 1952, defense expenditures of \$52.5 billion will absorb approximately 17 per cent of the national output, leaving 83 per cent of the greatest production ever known available for non-defense use. In two of the wartime years, more than 40 per cent of output went to defense, and this of course was 40 per cent of a substantially smaller physical capacity.

The figure of 17 per cent is in overall terms. In metal-using lines the requirements will be much greater, in many other lines much less. No sensible person would minimize the effort required, the dislocations, or the inflationary

problem. Nevertheless it should be possible for the country to accept the necessity for the diversion of 17 per cent of its stupendous output to defense with calmer and more discriminating judgment than has been the case in many quarters. To believe that the inflationary consequences of an effort of that magnitude are unmanageable, or the required sacrifices unbearable, is to distrust and belittle without reason the productive power of this country and its free economic system.

If people would ponder the significance of this figure, consumers might be less prone to scramble for goods for fear goods will disappear. The powerful political groups, including the labor unions and the farmers and their supporters in Washington, might think it less essential to erect defenses against reduction of their purchasing power or living standards. Government authorities and legislators might think it less necessary to rush into operation totalitarian techniques, and be more willing to use fully and depend on the anti-inflationary policies consistent with, and effective in, a relatively free economy. They might use less exhortation, which frequently backfires, and more sober, determined strength.

The fact is that all groups can work together in the national effort, bear the taxation and monetary and credit restrictions required, share the sacrifices, do without the comparatively few things which it will be necessary to do without, and still enjoy a living standard and a degree of prosperity which in comparison with most of the rest of the world can only be termed fabulous. Yet it is primarily the efforts of groups seeking to escape sacrifice, and their political defenders, which have brought the country into the shadow of a destructive inflation, or, alternatively, the shadow of a destructive impairment of the free economic organization through the spread of direct controls.

Fear of inflation now is itself one of the powerful inflationary influences. This fear can best be allayed by doing the things which all informed and experienced people believe to be necessary, namely, economizing, taxing and adopting appropriate money policy.

Financial Mobilization

In a speech on "Financial Mobilization", January 18, Secretary of the Treasury Snyder sketched out the main lines of the debt management policies he proposed to follow. The immediate occasion for an official statement on debt policy was the approach to maturity of the non-mar-

ketable Series E Savings bonds, sold to individuals to help finance the war. These first went on sale in May 1941 and there will be some falling due every month from May of this year onward. It had been known for some time that the Treasury had been studying possible means to encourage reinvestment by holders of maturing Savings bonds.

The decision announced by the Secretary was to give two alternatives to cash redemption: an exchange for a twelve-year Savings bond of Series G which pays $2\frac{1}{2}$ per cent interest currently; or, with Congressional approval, continued increase in redemption value for holding the Series E bond beyond its ten-year maturity. Under this last option a matured Savings bond purchased at \$75 and worth \$100 at maturity would increase in redemption value \$2.50 a year for seven and a half years and thereafter at a more rapid rate to afford a redemption value of \$133.33 ten years after the regular maturity and twenty years after original purchase. The plan has the merit of being simple and automatic. It affords the same 2.9 per cent compound rate of interest for the second ten-year period as for the first. It retains the option the holder has always had of deferring payment of income tax on the interest until the bond is finally redeemed. Once in effect, the automatic extension would apply to all outstanding Series E Savings bonds as they mature and to all new ones that are sold.

In his speech the Secretary stressed the importance of reducing the proportion of Federal securities held by the commercial banks and Federal Reserve Banks. Sale of regularly marketable bonds, principally to savings institutions, life insurance companies, and private pension funds, provide one means to this end. The sale of Savings bonds, now outstanding in the amount of \$35 billion for Series E alone and \$58 billion for all series combined, provides another. So far as Series E bonds are concerned, the record has not been favorable since the Korean war broke out; more bonds have been turned in for cash redemption than have been sold. This reflects consumer buying in anticipation of price advances and shortages, but it also reflects forebodings of a continuing shrinkage in the buying power of money over the life span of the bonds.

The surest means of stimulating bond sales is to convince the Savings bond investor that an effective anti-inflationary program is under way and that his money is not going to lose a large part of its value over a ten or twenty year period of investment. Shortages of consumers'

goods, when and if they develop, independently may spur sales of Savings bonds as a medium for storing up buying power. Savings bonds sold in World War II helped in this way to build a basis for prosperity after the war and for the amelioration of business slump.

Marketable Debt

Describing "very much higher taxes" as a necessary measure for avoiding "the evils of deficit-financing", the Secretary entered highly controversial territory when he expounded his ideas on interest rates to be offered on marketable long-term bonds in refunding and new borrowing programs. Appealing to investors and savers to make a financial sacrifice, the Secretary rejected recommendations he had received to improve the rate offered on future issues of long-term marketable bonds, above the $2\frac{1}{2}$ per cent maximum used in World War II, in order to make such obligations more readily saleable under prevailing market conditions. He described the idea that "fractional changes in interest rates can be effective in fighting inflation" as a "delusion" which "must be dispelled from our minds."

On the other hand, the Secretary took the position that the $2\frac{1}{2}$ per cent rate on long-term Treasury bonds had become "an integral part of the financial structure of our country." He expressed fear that "any increase in the $2\frac{1}{2}$ per cent rate would . . . seriously upset the existing security markets—government, corporate, and municipal":

In the firm belief, after long consideration, that the $2\frac{1}{2}$ per cent long-term rate is fair and equitable to the investor, and that market stability is essential, the Treasury Department has concluded, after a joint conference with President Truman and Chairman McCabe of the Federal Reserve Board, that the refunding and new money issues will be financed within the pattern of that rate.

When I came to the Treasury in June 1946, the war had been over less than a year, and war financing had only recently been completed. I felt at that time that stability in the Government bond market during the transition period was of vital importance. As the economy became more stabilized, the Treasury used more flexibility in its debt management program by allowing short term rates to increase gradually.

Later, beginning with the crisis in Korea, however, the considerations calling for stability in the Government bond market became tremendously important. The credit of the United States Government has become the keystone upon which rests the economic structure of the world. Stability in our Government securities is essential.

I do not think that we can exaggerate when we emphasize these matters. I think they are basic to our national survival.

A 2½ Per Cent "Pattern"

Mr. Snyder made it quite clear that he regarded 2½ per cent as a fixed rate for the indefinite future. His allusion to rate "pattern" naturally calls to mind the fixed rates adopted in 1942 for financing World War II. With this pattern, which ran from ½ per cent to 2½ per cent for various classes of securities, the Treasury was able to sell all the bonds it needed to finance the war and at the lowest rates in history. For this success there were four essential conditions: (1) the existence of a total war requiring enormous borrowings; (2) the carryover of a low rate structure from the depression of the 'thirties; (3) a drying up of private credit demands resulting from shutdowns of civilian goods production; and (4) a commitment by the Federal Reserve to feed out more money as needed from time to time to hold down market rates of interest.

The pattern scheme was a successful expedient. Federal Reserve officials, in retrospect, have held that it was in effect too successful, attracting too many sheerly speculative subscriptions, requiring too much Federal Reserve buying, and leaving the country at the end with a dangerously swollen money supply.

Fortunately, the question is not one that has to be settled immediately. The Secretary has indicated that the Government will have no new borrowing to do until the middle of the year, and the next heavy maturities of marketable bonds and notes, to be handled by exchange offer, do not begin until June and July. Neither is there, right now, substantial loose money around in the hands of institutional investors that a 2½ per cent bond issue could effectively tap. The several issues of 2½ per cent bonds already outstanding are quoted at moderate premiums above par but only because the Federal Reserve is in the market to take up surplus offerings. In the weeks ahead there is time which ought to be used for full and free public discussion of the vital issues raised by the Secretary.

The Reaction

The government bond market reacted buoyantly to Mr. Snyder's speech, particularly since his reference to Chairman McCabe of the Federal Reserve Board seemed to imply that the Federal Reserve was committed to the support of the 2½ per cent pattern. As it became evident that the Federal Reserve authorities had some reservations, prices promptly dropped back on the minimum price pegs that have been maintained since last November.

Public statements on credit policy, since the Secretary's speech, by members of the Federal Open Market Committee have omitted any endorsement of the Treasury plan. This Committee is the body charged with the responsibility of buying and selling government securities for the account of the Federal Reserve Banks.

Reserve Board Chairman McCabe, who is also Chairman of the Open Market Committee, speaking at Philadelphia on January 26, had no direct comment but listed the discount rate and open market operations among weapons that may have to be used to restrain credit expansion. Allan Sproul, President of the New York Federal Reserve Bank and Vice Chairman of the Open Market Committee, speaking in New York January 22, pointed out the inflationary risks in a "Government security market requiring extended periods of extraordinary support":

I am afraid that the announced debt management policy would lead us directly or indirectly into too much financing by the banks, *if we had to do any substantial amount of deficit financing*. And even in terms of possible refunding of bank-held debt, by sale of long-term obligations to nonbank investors who temporarily find other outlets for funds lacking, it would have shortcomings. It runs the risk of falling short of attracting willing nonbank investors in the first instance, and of creating reluctant holders of Government securities for the longer run.

We must have learned from our experience during and following the last war, with respect to market bonds, and more recently since the Korean fighting started, with respect to savings bonds, that these are real risks. If these risks were realized, they would mean that too much of our financing would sooner or later be done with bank credit based on the ready availability of Federal Reserve credit. And when that credit began to express itself in inflationary price advances, we would again find our powers to control the inflationary brew greatly impeded by the needs of a Government security market requiring extended periods of extraordinary support.

Fortunately, we are not faced with the necessity of deficit financing, nor should we be for as far ahead as one can see, if stern tax talk is followed by stern tax action. Despite the inspired comment of some of our market letters, deficit financing in the period we are now entering does not need to be immense; pay-as-you-go is not a pious proposal which ducks the facts; the magnitude of our borrowing needs does not require a market floating buoyantly on the promise of unlimited access to central bank credit.

Marriner Eccles, Governor of the Federal Reserve Board and ex-officio member of the Open Market Committee, testifying before the Congressional Joint Committee on the Economic Report on January 25, stated bluntly that: "Inflation and debasement of the value of the dollar is the price we pay for the luxury of a booming Government securities market":

If the Federal Reserve is to be required to maintain a fixed interest rate pattern set by the Treasury then the system should either be discharged of its responsibility for controlling the volume of credit and money or be given new powers as partial substitutes for those that it is not permitted to use.

In arguing for higher interest rates Governor Eccles asked why "the investor should be the forgotten man":

You don't hesitate to pay labor higher wages. You don't hesitate to pay defense contractors what they demand for their goods, you don't hesitate to pay parity to farmers. Why should investors get no consideration as the value of the dollar goes down?

The Present Pattern

The spectacular controversy between the Treasury and the Federal Reserve last autumn stemmed from the unwillingness of the Federal Reserve to continue to support a 1½ per cent short-term borrowing rate for the Treasury. The long-term 2½ per cent rate was not involved. Since late November the Federal Reserve has been stabilizing an unformalized pattern of rates running in a graduated fashion from 1½ per cent for 91-day paper and 1½ per cent for one-year up to 2½ per cent for the longest-term bonds. When bank reserve requirements were raised recently the Federal Reserve bought up government securities to maintain this pattern intact. Treasury bills were bought on a yield basis of 1.39 per cent; ten months' 1½ per cent notes at a discount below par of about \$1.90 per \$1,000, equivalent to a yield basis of 1.49 per cent; and Victory Loan 2½ per cents at a premium above par of around \$7 per \$1,000, equivalent to a yield basis of 2.45 per cent. Secretary Snyder's proposal in effect would place on the Federal Reserve the obligation to keep 2½ per cent bonds continuously and indefinitely above par, and also purchase other government securities on a set scale.

The Decline of Easy Money Abroad

Interestingly, the popularity of bond market management in favor of government treasuries has been waning in many foreign countries. People have waked up to the fact that price-pegging and very easy money breed inflation and weaken the essential function of saving. The British Government, after driving the market up to permit sale of 2½ per cent long-term bonds in 1946, withdrew support until supply and demand struck a balance at a lower price level. The Swedish Government gave up on a long-maintained fixed price peg for its 3 per cent bonds last summer, and allowed them to decline. The Bank of Canada, just within the last few weeks, has allowed Canadian "Victory Loan"

3 per cents to break par. In Germany rates have been jacked up to help restore the balance of payments.

On January 30 the British Chancellor of the Exchequer, Mr. Hugh Gaitskell, facing a problem similar to that here, announced an offering of 3 per cent Defense bonds to replace a current issue paying 2½ per cent. At the same time an increased rate of return was offered on future issues of ten-year Savings certificates, analogous to our Savings bonds. In making these announcements, Mr. Gaitskell stated:

The rearmament program makes it all the more necessary that there should be the greatest possible volume of savings.

This is an essential part of the policy of combating inflation and preventing price increases.

The 1952 Federal Budget

The 1952 federal budget is a staggering document. Calling for expenditures of \$71½ billion in the fiscal year beginning July 1, it will mean, if the President's recommendations are approved by Congress, a spending total exceeded only in the three peak years of World War II — 1943-45.

While the President estimated actual expenditures in fiscal '52 at \$71½ billion, he asked Congress for still larger sums in the form of authorizations for entering into new spending commitments during the year. This new obligational authority, including appropriations and loan and contract authorizations, footed up to \$94.4 billion, part of which will be spent in 1952 and the balance in subsequent years. In addition, the President asked for \$4.1 billion in appropriations to liquidate prior year contract authorizations. Thus the grand total new spending authority requested comes to \$98½ billion.

As against these vast spending totals, the President estimated 1952 receipts from present tax rates at approximately \$55 billion. Large as this is, it still indicates a deficit — compared with actual expenditures — of \$16½ billion. To avert this deficit, the President sees no room for cutting expenditures, but proposes only raising taxes.

Already, as shown in the table following, the presently expected yield of taxes for '52 far exceeds the total of any previous year. Yet the President proposes to pile on another \$16½ billion to balance the budget at \$71½ billion — and to ask for more money if expenditures go higher. According to figures given in the budget message, the program announced will mean raising the federal tax load to 26 per cent of the national income; and adding in some \$16 billion of state and local taxes will bring the ratio to

United States Government Budget Receipts, Expenditures, and Public Debt, 1914-1952

(In Millions of Dollars)

Year Ended June 30	Total Net Receipts	Total Net Expenditures	Net Surplus or Deficit	Public Debt, June 30
1914	\$ 735	\$ 735	\$ 0	\$ 1,188
1915	698	751	- 53	1,191
1916	782	794	+ 48	1,225
1917	1,124	1,973	- 853	2,976
1918	3,665	12,697	- 9,032	12,244
1919	5,152	18,515	-13,363	25,432
1920	6,995	6,403	+ 291	24,299
1921	5,825	5,116	+ 509	23,977
1922	4,109	3,373	+ 736	22,963
1923	4,007	3,295	+ 713	22,350
1924	4,012	3,049	+ 963	21,251
1925	3,780	3,053	+ 717	20,516
1926	3,963	3,098	+ 865	19,643
1927	4,129	2,974	+ 1,155	18,512
1928	4,042	3,103	+ 939	17,694
1929	4,083	3,299	+ 784	16,931
1930	4,178	3,440	+ 738	16,135
1931	3,190	3,652	- 462	16,801
1932	2,005	4,741	- 2,735	19,437
1933	2,080	4,651	- 2,571	22,539
1934	3,115	6,745	- 3,630	27,053
1935	3,300	6,592	- 3,292	28,701
1936	4,116	5,541	- 1,425	33,779
1937	5,029	8,706	- 3,677	36,425
1938	5,855	7,031	- 1,177	37,165
1939	5,103	9,966	- 4,863	40,440
1940	5,296	9,206	- 3,910	42,968
1941	7,227	13,387	- 6,160	48,961
1942	12,696	34,187	-21,491	72,422
1943	22,201	79,622	-57,421	136,696
1944	43,892	95,315	-51,423	201,003
1945	44,762	98,703	-53,941	258,632
1946	40,027	60,703	-20,676	269,422
1947	40,043	39,239	+ 754	258,286
1948	42,211	35,791	+ 8,419	252,292
1949	35,245	40,057	- 4,812	252,770
1950	37,045	40,156	- 3,111	257,357
1951 Est.	44,512	47,210	- 2,698	260,300
1952 Est.*	55,133	71,594	-16,456	276,300

* Excluding proposed new taxes.

around 30 per cent. While this is well below the peak figures reached during the past war, the latter ruled for only a brief period and were not, as at present, at the beginning of a period of partial mobilization that may last for years.

Though the public had been prepared for a large increase in budget totals, the figures announced by the President came as a shock. Not only is the projected rise in military spending greater than had been generally anticipated, but the public had looked for a much more determined effort to cut non-defense spending.

To the extent that the rise in national defense spending reflects genuine progress in increasing the effectiveness of the armed forces, it is of course all to the good. The failure, on the other hand, to accomplish significant results in reducing non-defense costs is a grave disappointment and calls for searching inquiry by both Congress and the public.

Defense vs. Non-defense Spending

Any attempt, however, to gauge the real trend of defense as against non-defense spending must recognize the danger of placing too much reliance on budget labels. Not only are many projects related to defense carried under other headings—for example, atomic energy is included under

"natural resources", and the government program for defense plant expansion appears under "finance, commerce, and industry"—but there is a strong tendency for many peacetime projects which are threatened with budget cuts to get wrapped in the protective mantle of "defense".

The next table gives the President's own figures as to major defense and non-defense outlays, based on a reclassification of budget items and given out as a special news release in connection with the budget message. It segregates "major national security programs" from other expenditures, and includes also "major fixed and continuing charges" the latter explained as including items not subject to annual budgetary control, such as interest on the public debt, as well as other programs governed largely by existing legislation but still subject in varying degree to administrative action.

Analysis of Budget Expenditures for Fiscal Years 1951 and 1952

(In Millions of Dollars)

	1951	1952
Budget Totals	\$47,210	\$71,594
Deduct:		
Major national security programs:		
Military services	20,994	41,421
International security	4,726	7,461
Atomic Energy Commission	818	1,277
Defense production and controls	296	1,403
Civil defense	15	330
Maritime activities	189	854
Defense housing and community facilities		100
Dispersal program	6	164
Total, major national security programs	27,044	52,510
Remainder	20,166	19,084
Deduct:		
Major fixed and continuing charges:		
Veterans services and benefits	5,746	4,911
Interest	5,722	5,897
Permanent and indefinite appropriations	1,485	1,866
Reconstruction Finance Corp.	-84	-42
Federal National Mortgage Association	189	-530
Commodity Credit Corporation	-150	252
Home Loan Bank Board	-92	-14
Public assistance grants	1,281	1,300
Public roads	469	473
International wheat agreement		77
Foot-and-Mouth disease control	2	33
Payment of claims and reserve for contingencies	141	225
Total, major fixed and continuing charges	14,709	13,948
Budget totals, excluding major national security, fixed and continuing charges	5,457	5,136

As the table shows, out of total proposed spending in fiscal '52 of \$71,594 million the President puts cost of "major national security programs" at \$52,510 million. This leaves spending for all other government purposes at \$19,084 million, down only \$1,082 million from estimated expenditures for corresponding purposes in fiscal '51. Measured against the kind of stern retrenchment the situation calls for, this is hardly more than a beginning.

The President goes on to deduct "major fixed and continuing charges" amounting in '52 to \$13,948 million, thus reducing the budget total—excluding "major national security, fixed and continuing charges"—to \$5,136 million. Even this comparatively small residual total, he contends, contains defense elements.

All of which seems calculated to give the impression that there is little more that can be done to cut the budget.

Actually, it will be hard to convince the American people, who are asked to make sacrifices in their own daily lives, that the meagre economies revealed by the President are all that can be squeezed out of the huge \$71½ billion spending total. There is not a single major classification of the budget that does not call for critical analysis.

Cutbacks Too Little and Too Few

In fairness to the Administration, it should be noted that some real effort appears to have been made to cut expenditures for some non-war activities. The financing of rural electrification and rural telephones is reduced from \$312 million in '51 to \$269 million in '52, and Corps of Engineers and Reclamation projects are down from the record-breaking \$1,011 million this year to \$873 million next year.

Expenditures for veterans' services and benefits are decreased \$835 million, due mainly to reduced enrollments for education and training. The change in the Federal National Mortgage Association from a net outlay to a net receipt of over \$500 million reflects the accelerated sales of home mortgages by that agency in keeping with the new policy of tightening up on mortgage credit.

The trouble is that these and other economies are too little and too few. The budget continues to provide hundreds of millions of dollars for such paternalistic programs as federal aid to education (\$300 million), school lunches (\$83 million), farm housing, rural electrification, federal power, and many other things. In addition, the budget proposes small beginning outlays for new spending projects destined to mushroom as time goes on, notably compulsory health insurance, and the initiation of seven new public power projects to cost eventually \$1.5 billion. While commencement of the latter is requested as part of the defense effort, the question arises as to how much of this expansion of electrical capacity could be done with private capital if given proper encouragement. The question is pertinent in view of the discouraging effect of public power encroachment

on plans of private utilities in many areas, and the known instances where a government department has actually sought to block power developments by private utility companies because the department itself wanted to develop them with public money.

Austerity for the Taxpayer Only

All in all, the impression gained from examination of the 1,032 pages of this massive budget is that, despite the dictum laid down in the State of the Union message that the Government "must practice rigid economy in its non-defense activities", actually it is an austerity budget for the taxpayer only.

It is encouraging that Congressional leaders of both parties have expressed their concern over these vast spending proposals. Chairman Robert L. Doughton, of the House Ways and Means Committee, is reported to have served notice on the Administration that he and his committee want non-defense spending cut before they approve new taxes. The studies by Senator Byrd and others have demonstrated that some \$6 to \$9 billion of "fat" can be cut out of the budget, if only there is the courage and determination to do it.

Experience has shown, however, that budget-cutting is a tough and discouraging assignment. It can be done, but it will need all the support that can be marshalled from the folks "back home". After all, the pressure for spending comes from outside as well as inside the Government. People have got to realize that they can't cry for economy in Government with one breath, and clamor in the next for that new dam or new post office or new veterans' hospital for their community.

Hindsight on an Old Bogey

The automobile and building industries' prodigious new production records in 1950 of 8 million passenger cars and trucks and over 11½ million new dwelling units recall to mind an old bogey that was worrying a good many people not so many years ago—the theory that the country had grown "mature" and that there were no longer the "new frontiers" for employment of capital and labor in dynamic growth there had been in the past. People recalled how the boom in railway construction had carried the country forward in the latter part of the 19th Century. They pointed to the mushrooming development of the automobile industry as the mainstay of the prosperity of the '20s. They asked despairingly where were the new industries comparable to these to provide employ-

ment for the growing resources of capital and manpower and to prevent economic stagnation.

The literature of the '30s is replete with these forebodings. Thus in the proceedings at the annual meeting of the American Economic Association in December 1938 we find the following expression (it may be charitable to omit the speaker's name):

It is my growing conviction that the combined effect of the decline in population growth, together with the failure of any really important innovations of a magnitude sufficient to absorb large capital outlays weighs very heavily as an explanation for the failure of the recent recovery to reach full employment.

In a similar vein is the following excerpt from another paper read at the same meeting:

Should new industries fail to materialize in sufficient volume to demand large private capital outlays, a continued expansion of the demand for capital goods appears to be contingent on the assumption of large responsibilities by local, state and federal governments to provide for the expansion of investment.

During World War II, when the nation's industries were largely converted to the production of military supplies and other goods essential to winning the war, there was much discussion of plans for new postwar products—many of them only in the "dream" stage—that might help to sustain business after the fighting ended. The Wall Street Journal in an editorial on August 7, 1944 expressed the prevalent question as follows:

After the last war, the rapid development of the automobile industry led the country to unprecedented prosperity. What industry is in sight to take the leadership now?

The editorial went on to say that the leaders in the automobile industry seemed to be offering an answer to the question, and that the answer was simply this: "The automobile industry."

The past few years have given dramatic confirmation to this prediction. It was not the great new industry that the economic observers of the '30s were so anxiously scanning the horizons for to take the leadership, but our old friend the automobile industry, together with the age-old enterprise of building.

New industries, it is true, there have been in plenty—television, plastics, synthetic rubber and textiles, new discoveries in chemicals and in countless other directions—and they have contributed mightily to the creation of new jobs and new wealth. But it has been the automobile industry, together with home building, that emerged as the outstanding factor supporting general business prosperity—the same as took place after World War I—and made a

mockery of the term "mature economy". The worry today is that these industries are hitting too fast a pace, in view of the need of conserving materials for the defense program.

Automobiles, 1929-1950

How the automobile industry has forged ahead is strikingly illustrated by preliminary figures for 1950 given out recently by the Automobile Manufacturers Association. The following table shows the growth since 1929, the old prewar production peak:

Comparison of American Automobile Industry, 1929-1950

	1929	1950	% Change
Production — Numbers			
Passenger cars (Thousands)	4,587	6,666	+ 45
Trucks and buses	771	1,337	+ 73
Total	5,358	8,003	+ 49
Production — Wholesale Value			
Passenger cars (Millions)	\$2,847	\$8,825	+210
Trucks and buses	566	1,670	+195
Total	3,413	10,495	+208
Motor Vehicle Registration			
Passenger cars (Thousands)	23,060	39,710	+ 72
Trucks and buses	3,442	8,770	+155
Total	26,503	48,480	+ 83
Employed in Automobile and Parts Industry			
Total employment (Thousands)	518	840	+ 62
Production workers only:			
Number	471	715	+ 52
Payrolls (Millions)	\$ 789	\$2,700	+242
Average weekly earnings	\$32.20	\$72.85	+126
Average weekly hours	46.8	41.2	- 12
Average hourly earnings	\$0.688	\$1.765	+157
Special Motor Vehicle Taxes			
State and local (Millions)	\$ 850	\$2,880	+239
Federal excise	—	1,440	—
Total	\$ 850	\$4,320	+408
Highway Expenditures			
Federal, state and local (Millions)	\$2,194	\$4,000	+ 82
Gasoline Consumption by Motor Vehicles			
(Million gallons)	14,139	35,600	+152

Source: Automobile Manufacturers Association; 1950 figures preliminary.

Between these two years production of passenger cars and trucks increased from around 5.3 million to 8 million, or by 49 per cent over the old peak. As compared with the low years of the late '30s, when people were talking about the "mature economy" and the "saturation point" for automobiles, production has more than doubled.

Registration of motor vehicles hit a peak of over 48½ million in 1950. In 1929 the registration was 26½ million, and in 1909 it was but 312,000. The United States, with only 6 per cent of the world's population, has 77 per cent of the world's cars and 52 per cent of the trucks. More than 73 per cent of all families in this country now own cars.

Expansion in automobile production has been both cause and effect of similar growth in a host of important related industries, such as the manufacture of parts, tires, batteries, etc., pe-

troleum refining, auto sales and servicing, construction and maintenance of over 3 million miles of public roads, financing automotive products all along the line, liability and other insurance coverage, motels and tourist camps, and — last though by no means least — the collection of taxes.

Special taxes collected from motor vehicle users in 1950 included state registration receipts of \$905 million, state gasoline taxes of \$1,725 million, city and county taxes of \$100 million, toll charges of \$150 million, and federal excise taxes of \$1,440 million — a total of \$4,320 million. And this does not include the regular corporate and individual income, property, and sales taxes paid by the thousands of concerns and by the millions of people engaged in producing, distributing, servicing, and operating motor vehicles.

By its continuous improvements in methods of mass production and its tremendous investments of new capital for better plants and equipment, this industry has been able not only to make America a nation of car owners, but in the process to provide jobs for more and more people, to increase wages and at the same time to shorten working hours.

New Frontiers in Home Building

Similarly, we have been discovering "new frontiers" in home building. Back in the '30s economic pundits were talking about the decline in population growth, with its retarding effect on home building, as one of the symptoms of our "mature economy".

That time has not borne out this prediction is evident from the record total of more than 1 1/3 million new dwelling units started in 1950, as against 937,000 in 1925. While this showing is partly the result of the Government's extraordinary liberality in financing home building, it has been due also to the fact that people born in the 'twenties, when birth rates were relatively high, have been reaching home-seeking ages. Not only has home building had to make up for low levels of building during the war and the preceding depression, but it has been a natural reflection of the general state of prosperity, the desire of the people for better homes, and the great strides made by the building in-

dustry, including suppliers of materials and fixtures, in adapting new home construction to modern living requirements.

In other words, it's another example of the old American story of growth and progress in supplying the people with what they want.

The Lesson

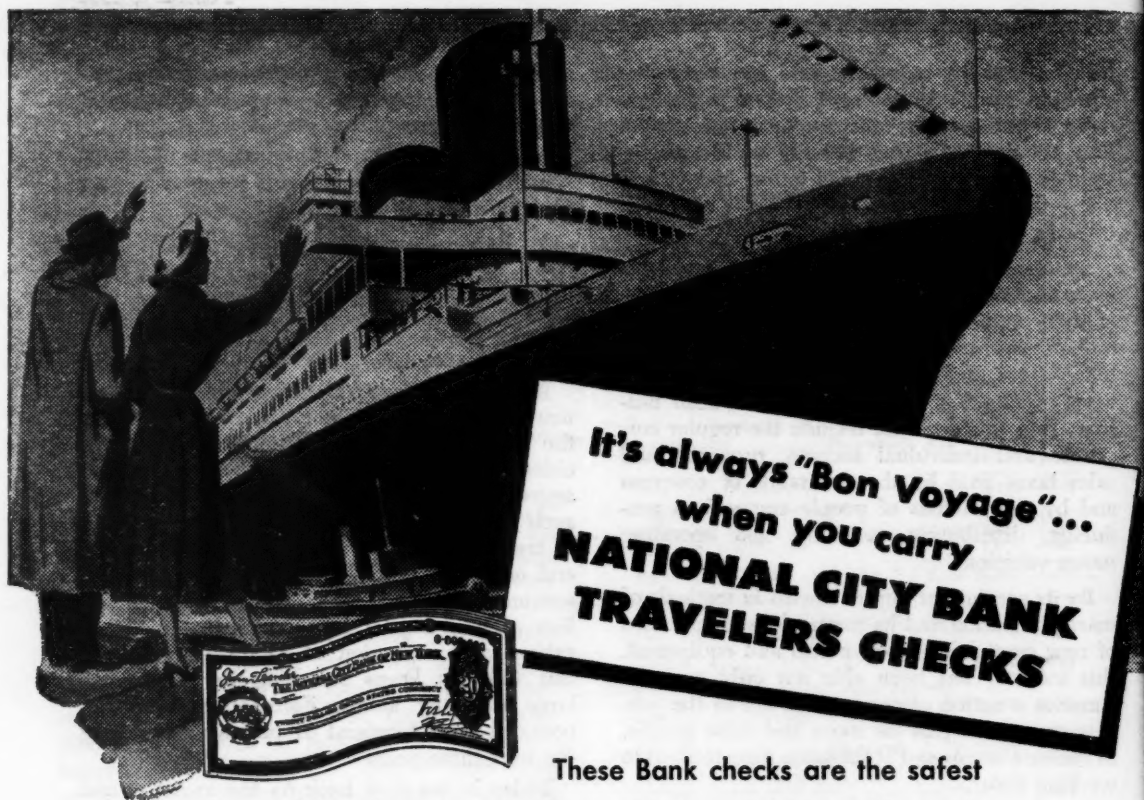
The lesson of this experience is clear. We don't have to pin our hopes on some "great new industry" coming along every so often to keep us employed and moving ahead.

Important as are the discoveries that open new industrial trails, progress comes also from the constant evolution and improvement in the older industries where scientific invention and aggressive leadership bring about changes of such sweeping character as to be tantamount to creation of whole new industries. Since the end of World War II the supposedly "mature" automobile industry has invested over \$2 billion of new capital in reconversion, modernization, and expansion of facilities. And still this industry keeps renewing its youth; one large company alone — Ford Motor — has announced plans to spend \$1 billion more during the next three years.

Today as we look back on the anxieties and doubts of the '30s, we can recognize the old familiar pessimism of hard times. The '30s were not the first time that Americans have prophesied that opportunities for growth and development had come to an end, only to have their statements look foolish by what came after.

The important thing is in preserving the spirit of enterprise which has overcome obstacles and enabled our economy to rise to new heights after every setback. The great danger now, as we face the expanding national defense program, is in smothering this spirit with taxes and controls over both business and individual life. While higher taxes and more controls are inevitable in this emergency, we must guard against carrying them to the point of holding back industrial growth. In the present international situation, much more than the question of a "mature economy" is at stake. Our very survival depends as much upon constant improvement in the productivity and efficiency of our industries as upon the defense program itself.

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